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C O N F I D E N T I A L SECTION 01 OF 02 BRASILIA 001849

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SUBJECT: LULA FACES WORST CRISIS OF HIS PRESIDENCY

REF: A. BRASILIA 1682

[1B](#). BRASILIA 1819

Classified By: POLOFF RICHARD REITER FOR REASONS 1.4 B AND D.

[¶11.](#) (C) SUMMARY. Since mid-May, when a series of interlocking scandals (dubbed the "Postal Service" and the "Big Monthly" scandals) began to unfold in Brazil, President Lula da Silva, his administration, his coalition, and his Workers' Party (PT) have been battered by the gravest political crisis of his presidency. The list of casualties is long, and may grow longer. Lula's powerful Chief of Staff, Jose Dirceu, resigned on June 16, PT party president Jose Genoino (a close Lula confidant) and two other party officials resigned on July 9. Three right-of-center parties in Lula's coalition in Congress (PTB, PL, and PP) have been directly implicated in the scandals. As a result, Lula has been forced to shake up his cabinet, sending two cabinet ministers to take over the wounded PT party leadership and offering as many as four cabinet slots to its unreliable coalition partner, the PMDB party.

[¶12.](#) (C) Lula himself has not been touched by the scandals, and his personal popularity is relatively unscathed. But with the administration in a state of rolling crisis, the coalition in disarray, and Congress spending most of its time engaged in finger-pointing and investigative committees, Lula is facing a challenge to his governability. He is still odds-on to run for, and win, a second term in the October 2006 elections, but his prospects have been damaged. It seems unlikely that any significant legislation will pass in the meantime unless it gathers support from the opposition or (like a political party reform bill now in committee) gets a push from the current crisis. Lula has shown no signs of altering either his fiscal stability or foreign policies, but the crises will prevent him from taking the initiative in most other areas. END SUMMARY.

CORRUPTION CHARGES DOG THE PT PARTY

[¶13.](#) (C) The mid-May revelations that senior officials in the Brazilian Postal Service, linked to the coalition's PTB party, were soliciting bribes kicked off an expanding series of scandals that continues to batter the Brazilian government. As those caught up in the allegations scrambled to defend themselves, they revealed further schemes, and the crisis widened. Among the most serious allegations to date is that senior officials in President Lula's Workers' Party (PT) managed a scheme fueled by undeclared cash used for everything from campaign financing of PT and allied candidates to vote-buying in Congress. These allegations have triggered the resignations of Lula's Chief of Staff, Jose Dirceu, and the three most senior PT party officials including party president Jose Genoino, a long-time Lula confidant.

PT'S FUTURE AT STAKE

[¶14.](#) (C) Looking to restore order in the party, Lula sent two well-regarded cabinet ministers --Education Minister Tarso Genro and Labor Minister Ricardo Berzoini-- to take over the PT leadership. Genro quickly announced new accountability rules for members. Though the PT has long nurtured an image of probity, in recent years it has moved aggressively toward the center and grown dramatically in size while allying with center-right parties of dubious character. Party moderates, led by Dirceu and Genoino, who masterminded this evolution are now among those feeling the greatest heat. Diehard leftists in the party, feeling doubly betrayed, are clamoring to take the PT in a new direction, and they will get their chance in September when party-wide elections choose new directors.

[¶15.](#) (C) The new PT directors will decide whether to stay the course of a moderate "PT Lite" and will also set the tone for the administration's direction heading into the 2006 elections. Moderates such as interim PT president Tarso Genro still command the majority of the rank-and-file and are likely to be reelected to lead the party. But if the leftists capitalize on outrage over the scandals and take over the PT leadership, look for them to push Lula to shed untrustworthy allies (PTB, PL, PP) and even to break with the large but divided PMDB. In such a scenario, the effect on administration policies and policy platforms for the 2006 campaign would be entirely unpredictable.

CABINET SHUFFLE AND COALITION DYNAMICS IN PLAY

16. (C) Dirceu's June 16 resignation was the first round of the cabinet shuffle. Since then, Lula has swapped out five more cabinet ministers --two of whom took over the top posts at the PT party, one replaced Dirceu as Chief of Staff, and two others stepped down for other reasons (ref B). The breakup is likely to continue in the coming days as Lula asks for resignations of Ministers planning to run for office in 2006. Two trends are apparent in Lula's choices: one is an attempt to shore up a crumbling coalition by locking in the large but divided PMDB party as an ally --which, if successful, would allow Lula the luxury of relying less on the medium-sized parties-for-rent that have gotten him into such trouble in recent weeks. To make it work, Lula will have to win over the PMDB's substantial "anti-Lula" wing, with a combination of cabinet posts, patronage jobs, and pledges of mutual support in the 2006 elections. The second trend is that Lula is showing himself unafraid to name "technical experts" rather than "political" cabinet ministers, in a quest for competence and to reduce political complications.

COMMENT - LULA'S GOVERNABILITY AT RISK

17. (C) Lula's personal exposure in the scandals appears limited to the nature of "what he knew and when he knew it". A poll last week indicates about 40 percent of Brazilians surveyed believe Lula had some knowledge of improprieties. If this were proved, he would be vulnerable to allegations that he was remiss in his duty to address corruption brought to his attention. With Dirceu's resignation as Chief of Staff, the administration hopes to quarantine the President from the crisis, keeping it restricted to Congress and the affected parties. But Lula's political problems are acute. With the cabinet in flux, the administration is enduring a rolling crisis and revolving door of ministers. The coalition is in tatters, with the allies accusing each other of wrongdoing and some expulsions from Congress on the menu. The result is an administration that has neither the floor votes nor the political capital to push its agenda through Congress. Congress is in semi-recess in July, but the noisy investigative committees continue unabated, calling witnesses and generating headlines.

18. (C) By all accounts, Lula still seems certain to run for a second term in 2006 and should be the odds-on favorite, though he looks less invincible than he did a few months ago. But the future of the PT party, both internally and in its image with voters, remains a question mark at least through the party convention in September. Lula's ability to reanimate his supporters with sweeping policy initiatives is hampered by his coalition problems. In short, the administration's field of action for the foreseeable future may be restricted to foreign and economic policies, the two areas where many Brazilians give Lula his highest marks and where he seems most likely to stay the course.

CHICOLA